

Decision **DRAFT DECISION OF ALJ DUDA** (Mailed 3/27/2003)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of Application for Approval of the
Indirect Transfer of Control of DSLnet
Communications, LLC (U-6191-C) to
VantagePoint Venture Partners.

Application 01-11-017
(Filed November 8, 2001)

**OPINION GRANTING INDIRECT TRANSFER OF CONTROL
AND FINING APPLICANTS FOR VIOLATION OF SECTION 854(a)
OF THE PUBLIC UTILITIES CODE**

1. Summary

This decision grants Application (A.) 01-11-017 to the extent the application requests prospective authority under Pub. Util. Code § 851 through 854¹ for VantagePoint Venture Partners (VPVP) to acquire indirect control of DSLnet Communications, LLC (DSLnet). This decision denies A.01-11-017 to the extent the application requests retroactive authority for the acquisition. Finally, this decision requires VPVP and DSLnet (jointly “Applicants”) to pay a fine of \$5,000.00 for their failure to obtain Commission authorization for this transfer of control, as required by § 854(a), prior to consummating the transaction.

2. Background

DSLnet is a Delaware corporation authorized to provide resale and limited facilities-based competitive local exchange services and interLATA and

¹ All statutory references are to the Pub. Util. Code unless otherwise indicated.

intraLATA telecommunications services in California.² DSLnet offers high-speed data connections to its customers in Monterey, Scotts Valley, Salinas and Santa Cruz.

VPVP is a private investment firm and limited partnership comprised of four affiliated private investment funds with more than \$2.5 billion in capital under management. VPVP's investments are primarily involved in networking, communications services, semiconductor, and Internet infrastructure companies.

3. Requested Authority

On November 8, 2001, Applicants filed this application requesting approval of an indirect transfer of control of DSLnet to VPVP. The proposed transaction is a private equity financial transaction wherein VPVP will acquire an ownership interest in DSLnet's holding company parent, DSL.net, Inc. Pursuant to a stock purchase agreement with VPVP, DSL.net, Inc. will issue and sell preferred stock and warrants to VPVP in exchange for VPVP providing \$15 million in equity financing to DSL.net, Inc. The stock purchase transaction will take place in three installments, from November 14, 2001 through February 28, 2002, which will increase VPVP's ownership interest in DSL.net, Inc. from 33.9% to 71.1%. Because the proposed transaction increases VPVP's ownership interest in DSL.net, Inc. to more than 50%, the transaction results in the indirect transfer of control of DSLnet.

² See Decision (D.) 99-10-025, D.99-06-083, and D.99-06-025. California is divided into 10 Local Access and Transport Areas (LATAs) of various sizes, each containing numerous local telephone exchanges. "InterLATA" describes services, revenues, and functions that relate to telecommunications originating in one LATA and terminating in another. "IntraLATA" describes services, revenues, and functions that relate to telecommunications originating and terminating within a single LATA.

Applicants state that the proposed transaction will enable DSLnet to access funds that are critically needed to maintain and expand its service and operations. They contend that the transaction will not cause any changes to the current management or operations of DSLnet and will be seamless and transparent to DSLnet customers in California. Following the indirect transfer of control of DSLnet's parent company to VPVP, DSLnet will continue to offer its current services with no changes in the rates, terms or conditions of service. There were no protests to the application.

4. Amended Application

In response to a ruling from the assigned Administrative Law Judge requesting further information about the transaction, including a copy of the proposed agreement between Applicants, Applicants filed an amended application on January 7, 2002. The amendment indicated that the first installment of the indirect transfer of control had taken place on November 14, 2001 and that Applicants were now requesting retroactive, or "nunc pro tunc"³ approval of the transaction. The closing of the first installment of the transaction increased VPVP's ownership interest in DSL.net, Inc. to greater than 50 percent, resulting in the indirect transfer of control of DSLnet to VPVP. Applicants claim that financial circumstances compelled them to move forward with the transaction prior to receiving Commission approval to avoid interruption of service to DSLnet customers.

³ The phrase "nunc pro tunc," meaning "now for then," refers to those acts which are allowed to be done at a later time "with the same effect as if regularly done." (Blacks Law Dictionary (4th Revised ed. (1968), p. 1218).)

5. Discussion

a. The Application Should be Approved on a Prospective Basis Only

In this application, Applicants request authority under §§ 851 through 854 for VPVP to indirectly acquire DSLnet through an equity financing transaction with DSLnet's parent, DSL.net, Inc. Section § 854(a) states, in relevant part, as follows:

No person or corporation...shall merge, acquire, or control...any public utility organized and doing business in this state without first securing authorization to do so from the commission...Any merger, acquisition, or control without that prior authorization shall be void and of no effect.

The Commission has broad discretion to determine if it is in the public interest to authorize a transaction pursuant to § 854(a).⁴ The primary standard used by the Commission to determine if a transaction should be authorized under § 854(a) is whether the transaction will adversely affect the public interest.⁵ The Commission may also consider if the transaction will serve the public interest.⁶ Where necessary and appropriate, the Commission may attach conditions to a transaction in order to protect and promote the public interest.⁷

⁴ D.95-10-045, 1995 Cal. PUC LEXIS 901, *18-19; and D.91-05-026, 40 CPUC 2d 159, 171.

⁵ D.00-06-079, p. 13; D.00-06-057, p. 7; D.00-05-047, p. 11 and Conclusion of Law (COL) 2; D.00-05-023, p. 18; D.99-03-019, p. 14; D.98-08-068, p. 22; D.98-05-022, p. 17; D.97-07-060, 73 CPUC 2d 601, 609; D.70829, 65 CPUC 637, 637; and D.65634, 61 CPUC 160, 161.

⁶ D.00-06-005, 2000 Cal. PUC LEXIS 281, *4; D.99-04-066, p.5; D.99-02-036, p. 9; D.97-06-066, 72 CPUC 2d 851, 861; D.95-10-045, 62 CPUC 2d 160, 167; D.94-01-041, 53

Footnote continued on next page

For the following reasons, we conclude that it is reasonable to grant this application to the extent it requests prospective authority under § 854(a) for VPVP to acquire indirect control of DSLnet. First, there will be no change to rates, services, or operations of DSLnet as a result of the transaction. Thus, DSLnet's customers and the public will not be harmed by the change in control of DSLnet's parent company. Second, Applicants have provided information indicating that VPVP's management has the telecommunications experience and technical, managerial, and financial qualifications necessary to exercise control over DSLnet. Third, the public may benefit from the indirect transfer of control to the extent the transaction enhances DSLnet's ability to maintain and expand its services and operations in California. Fourth, there is no opposition to this application. For these reasons, we see no reason to withhold authority for the transfer of control before us here.

We deny this application to the extent it requests retroactive authority under § 854(a) for VPVP to control DSLnet. The purpose of § 854(a) is to enable the Commission to review a proposed acquisition, *before it takes place*, in order to take such action as the public interest may require.⁸ Granting this application on a retroactive basis would thwart the purpose of § 854(a). The Commission has

CPUC 2d 116, 119; D.93-04-019, 48 CPUC 2d 601, 603; D.86-03-090, 1986 Cal. PUC LEXIS 198 *28 and COL 3; and D.8491, 19 CRC 199, 200.

⁷ D.95-10-045, 62 CPUC 2d 160, 167-68; D.94-01-041, 53 CPUC 2d 116, 119; D.90-07-030, 1990 Cal. PUC LEXIS 612 *5; D.89-07-016, 32 CPUC 2d 233, 242; D.86-03-090, 1986 Cal. PUC LEXIS 198 *84-85 and COL 16; and D.3320, 10 CRC 56, 63.

⁸ D.99-02-061, 1999 Cal. PUC LEXIS 56 *12; D.98-07-015, 1998 Cal. PUC LEXIS 526 *7; D.98-02-005, 1998 Cal. PUC LEXIS 320 *8; D.97-12-086, 1997 Cal. PUC LEXIS 1168 *8; and San Jose Water Co. (1916) 10 CRC 56, 63.

enacted careful guidelines for scrutiny of the owners of competitive local exchange carriers and we cannot condone the transfer of control of a competitive local exchange carrier to an owner that has not passed through our approval process in advance.

Since we will not grant retroactive authority, VPVP's acquisition of control over DLSnet is void under § 854(a) for the period of time prior to the effective date of this decision. The Applicants are at risk for any adverse consequences that may result from their having completed the transfer of control without Commission authority.

b. Applicants Should be Fined for Their Failure to Comply with Pub. Util. Code §854(a)

Applicants failed to comply with § 854(a) by VPVP acquiring indirect control of DSLnet without Commission authorization. Violations of § 854(a) are subject to monetary penalties under § 2107 which states as follows:

Any public utility which violates or fails to comply with any provision of the Constitution of this state or of this part, or which fails or neglects to comply with any part or provision of any order, decision, decree, rule, direction, demand, or requirement of the commission, in a case in which a penalty has not otherwise been provided, is subject to a penalty of not less than five hundred dollars (\$500), nor more than twenty thousand dollars (\$20,000) for each offense.

For the following reasons, we conclude that the Applicants should be fined for their failure to comply with § 854(a). First, any violation of § 854(a), regardless of the circumstances, is a serious offense that should be subject to fines. Second, the imposition of a fine will help to deter future violations of § 854(a) by the Applicants and others.

To determine the size of the fine, we shall rely on the criteria adopted by the Commission in D.98-12-075. We address these criteria below.

Criterion 1: Severity of the Offense

In D.98-12-075, the Commission held that the size of a fine should be proportionate to the severity of the offense. To determine the severity of the offense, the Commission stated that it would consider the following factors:⁹

Physical harm: The most severe violations are those that cause physical harm to people or property, with violations that threatened such harm closely following.

Economic harm: The severity of a violation increases with (i) the level of costs imposed upon the victims of the violation, and (ii) the unlawful benefits gained by the public utility. Generally, the greater of these two amounts will be used in setting the fine. The fact that economic harm may be hard to quantify does not diminish the severity of the offense or the need for sanctions.

Harm to the Regulatory Process: A high level of severity will be accorded to violations of statutory or Commission directives, including violations of reporting or compliance requirements.

The number and scope of the violations: A single violation is less severe than multiple offenses. A widespread violation that affects a large number of consumers is a more severe offense than one that is limited in scope.

Applicants' violation of § 854(a), while serious, was not an especially egregious offense. This is because the violation did not cause any physical or economic harm to others. In addition, there is no evidence that the Applicants

⁹ 1998 Cal. PUC LEXIS 1016, *71 - *73.

significantly benefited from their unlawful conduct. Furthermore, the violation of § 854(a) affected few, if any, consumers. The only factor that indicates the violation should be considered a grave offense is our general policy of according a high level of severity to any violation of the Public Utilities Code. However, this factor must be weighed against the other factors indicating that Applicants' failure to comply with § 854(a) was not an especially egregious offense.

Criterion 2: Conduct of the Utility

In D.98-12-075, the Commission held that the size of a fine should reflect the conduct of the utility. When assessing the conduct of the utility, the Commission stated that it would consider the following factors:¹⁰

The Utility's Actions to Prevent a Violation: Utilities are expected to take reasonable steps to ensure compliance with applicable laws and regulations. The utility's past record of compliance may be considered in assessing any penalty.

The Utility's Actions to Detect a Violation: Utilities are expected to diligently monitor their activities. Deliberate, as opposed to inadvertent wrongdoing, will be considered an aggravating factor. The level and extent of management's involvement in, or tolerance of, the offense will be considered in determining the amount of any penalty.

The Utility's Actions to Disclose and Rectify a Violation: Utilities are expected to promptly bring a violation to the Commission's attention. What constitutes "prompt" will depend on circumstances. Steps taken by a utility to promptly and cooperatively report and correct violations may be considered in assessing any penalty.

¹⁰ 1998 Cal. PUC LEXIS 1016, *73 - *75.

Applicants did not disclose their violation of § 854(a) until asked by the assigned ALJ,¹¹ which suggests that a larger fine may be appropriate. However, this factor is offset by Applicants' other conduct. First, there is no evidence that the Applicants have previously failed to comply with applicable statutes and regulations. Second, the Applicants took appropriate steps to report and remedy the violation once it was discovered (i.e., requesting retroactive authority for the acquisition).

Criterion 3: Financial Resources of the Utility

In D.98-12-075, the Commission held that the size of a fine should reflect the financial resources of the utility. When assessing the financial resources of the utility, the Commission stated that it would consider the following factors:¹²

Need for Deterrence: Fines should be set at a level that deters future violations. Effective deterrence requires that the Commission recognize the financial resources of the utility in setting a fine.

Constitutional limitations on excessive fines: The Commission will adjust the size of fines to achieve the objective of deterrence, without becoming excessive, based on each utility's financial resources.

¹¹ On December 13, 2001, the assigned ALJ issued a ruling that instructed the Applicants to amend their application to provide several items missing from the original application. In a phone conversation with the ALJ on December 17, 2001, Applicants indicated that the first installment of the transaction had occurred on November 14, 2001.

¹² 1998 Cal. PUC LEXIS 1016, *75 - *76.

For the six-month period ending June 30, 2001, DSLnet's parent company, DSLnet, Inc., had revenues of \$19.1 million and a net loss of \$82.8 million.¹³ DSLnet, Inc's total equity on June 30, 2001, was \$67.4 million.¹⁴ The financial statements of VPVP indicate for the nine-month period ending September 30, 2001, VPVP's four investment funds had total interest and dividend income of \$1.6 million, losses of \$41.1 million, and partners' capital of \$585.7 million.¹⁵ The Applicants have incurred significant losses in 2001, but their financial statements indicate healthy amounts of equity. Applicants have also contended that the purpose of the transfer of control was to obtain a much needed infusion of cash for DSLnet, Inc.'s ongoing operations. We will weigh these factors accordingly when setting the amount of the fine.

Criterion 4: Totality of the Circumstances

In D.98-12-075, the Commission held that a fine should be tailored to the unique facts of each case. When assessing the unique facts of each case, the Commission stated that it would consider the following factors:¹⁶

The degree of wrongdoing: The Commission will review facts that tend to mitigate the degree of wrongdoing as well as facts that exacerbate the wrongdoing.

The public interest: In all cases, the harm will be evaluated from the perspective of the public interest.

¹³ A.01-11-017, Exhibit A, p. 3.

¹⁴ *Id.*, p. 2.

¹⁵ Amendment to A.01-11-017, January 7, 2002, Exhibit 2.

¹⁶ 1998 Cal. PUC LEXIS 1016, *76.

The facts of this case indicate that the degree of wrongdoing, though serious, was not egregious. First, Applicants took steps to report and remedy their violation of § 854(a). Second, no one was harmed by Applicants' failure to comply with § 854(a). Finally, Applicants do not appear to have materially benefited from their unlawful conduct. These same facts also indicate that the public interest was not significantly harmed by Applicants' violation of § 854(a).

Criterion 5: The Role of Precedent

In D.98-12-075, the Commission held that any decision which imposes a fine should (1) address previous decisions that involve reasonably comparable factual circumstances, and (2) explain any substantial differences in outcome.¹⁷

The facts of this case are generally comparable to many Commission decisions that approved, without penalty, transactions that were effected without prior Commission authorization in violation of § 854(a).¹⁸ However, in D.00-09-035 we held that our precedent of meting out lenient treatment to those who violate § 854(a) had failed to deter additional violations; and we indicated that henceforth we would impose fines in order to deter future violations of

¹⁷ 1998 Cal. PUC LEXIS 1016, *77.

¹⁸ The following Commission decisions approved, without penalty, transactions that had been consummated without Commission authorization in violation of § 854(a): D.00-09-033, D.00-04-014, D.99-12-039, D.99-11-010, D.99-10-007, D.99-06-016, D.99-03-030, D.97-12-072, D.97-09-097, D.96-05-067, D.95-07-051, D.95-05-009, D.94-12-062, D.94-05-030, D.93-07-009, D.89-06-024, D.89-02-004, D.87-03-048, D.86-02-005, D.85-10-017, D.84-07-077, D.84-06-087, D.83-05-018, and D.93673.

§ 854(a).¹⁹ Therefore, requiring the Applicants to pay a fine for violating § 854(a) would be consistent with D.00-09-035.

Conclusion: Setting the Fine

We previously concluded that the Applicants should be fined for their violation of § 854(a). The application of the criteria adopted by the Commission in D.98-12-075 to the facts of this case indicates that a small fine is warranted. First, Applicants' violation of § 854(a), though serious, was not a particularly severe offense. Second, Applicants' conduct was not egregious. Third, while Applicants have incurred losses in operations during 2001, they appear to have sufficient resources to pay a small fine. Fourth, the degree of wrongdoing was relatively minor. Finally, the public interest was not significantly harmed by the Applicants' violation of § 854(a).

We conclude based on the facts of this case that the Applicants should be fined \$5,000.00 for violating § 854(a). The fine we impose today is meant to deter future violations § 854(a) by the Applicants and other parties. We emphasize that the size of the fine we impose today is tailored to the unique facts and circumstances before us in this proceeding. We may impose larger fines in other proceedings if the facts so warrant.

¹⁹ D.00-09-035, pp. 10-11. D.00-09-035 required the applicants in that proceeding to pay a \$500 fine for violating § 854(a). In D.00-12-053, the Commission imposed a fine of \$5000 for a similar violation of §854(a).

6. Category and Need for Hearing

In Resolution ALJ 176-3076, dated November 30, 2001 the Commission preliminarily categorized this proceeding as ratesetting, and preliminarily determined that hearings were not necessary. Based on the record, we affirm that this is a ratesetting proceeding, and that hearings are not necessary.

7. Pub. Util. Code § 311(g)

The Commission mailed the draft decision of the ALJ in this matter to the parties in accordance with Section 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. There were no comments on the draft decision.

8. Assignment of Proceeding

Susan P. Kennedy is the Assigned Commissioner and Dorothy Duda is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. DSLnet is a resale and limited facilities-based competitive local exchange carrier and provider of interLATA and intraLATA telecommunications services in California.

2. On November 8, 2001, DSLnet and VPVP jointly filed A.01-11-017 for authority to transfer indirect control of DSLnet to VPVP.

3. VPVP acquired an ownership interest of more than 50% in DSLnet on November 14, 2001, prior to Commission approval of A.01-11-017.

4. Pub. Util. Code § 854(a) requires Commission authorization to transfer control of a public utility. Any transfer of control without Commission authorization is void under the statute.

5. VPVP has the technical, managerial, and financial qualifications necessary to exercise indirect control of DSLnet.

6. Applicants state that there will be will be no change in the management or operations of DSLnet as a result of its indirect transfer to VPVP.

7. Pub. Util. Code § 2107 provides the Commission with authority to impose a penalty of between \$500 and \$20,000 for violations of the Public Utilities Code.

8. In D.98-12-075 the Commission adopted the following criteria for determining the amount of a fine: (i) the severity of the offense, (ii) the conduct of the utility, (iii) the financial resources of the utility, (iv) the totality of the circumstances, and (v) the role of precedent.

9. Applicants failure to comply with § 854(a) did not harm others and did not significantly benefit the Applicants.

10. There is no evidence that Applicants have previously failed to comply with applicable statutes and regulations.

11. Applicants took steps to report and remedy their violation of § 854(a) once they became aware of it.

12. Applicants have adequate financial resources to pay a small fine.

13. The Commission's lenient treatment of parties that violate § 854(a) has not deterred subsequent violations of § 854(a) by other parties.

Conclusions of Law

1. This is a ratesetting proceeding and no hearing is necessary.

2. A.01-11-017 should be approved on a prospective basis because it is not adverse to the public interest and the public may benefit from DSLnet's ability to maintain and expand its services and operations in California.

3. A.01-11-017 should be denied to the extent it requests retroactive approval of the transfer of control described therein.

4. Applicants violated § 854(a) by transferring indirect control of DSLnet to VPVP before receiving Commission authorization. Applicants' violation of § 854(a) is subject to monetary penalties under § 2107.

5. Applicants' should be fined for violating § 854(a). The amount of the fine should be based on the criteria set forth in D.98-12-075.

6. Applicants' violation of § 854(a), though a serious matter, was not an especially severe offense.

7. The public interest was not significantly harmed by Applicants' violation of § 854(a).

8. The application of the criteria in D.98-12-075 to the facts of this case indicates that Applicants should pay a fine of \$5,000.00 for violating § 854(a).

9. It is necessary to fine Applicants for violating § 854(a) in order to deter future violations of § 854(a) by Applicants and others.

O R D E R

IT IS ORDERED that:

1. Application (A.) 01-11-017, as amended, for authority under Pub. Util. Code § 854(a) to transfer control of DSLnet Communications, LLC (DSLnet) to VantagePoint Venture Partners (VPVP) is granted to the extent it requests authority effective as of the date of this order for VPVP to exercise indirect control over DSLnet. A.01-11-017, as amended, is denied to the extent it requests retroactive authority for the transfer of control.

2. DSLnet and VPVP (Applicants) shall notify the Director of the Commission's Telecommunications Division in writing of the transfer of control, as authorized herein, within 10 days of this order. A true copy of the instrument(s) of transfer shall be attached to the notification.

3. Applicants shall pay a fine in the amount of \$5,000.00 for violating Pub. Util. Code § 854(a). Applicants shall pay the fine within 20 days from the effective date of this order by tendering to the Fiscal Office of the California Public Utilities Commission a check in the amount of \$5,000.00 made payable to the State of California General Fund. Applicants shall file proof of payment at the Commission's Docket Office within 40 days of payment.

4. Application 01-11-017 is closed.

This order is effective today.

Dated _____ at San Francisco, California.